NATURAL GAS OUTLOOK 2006-2016
COMMENTS OF ORA ON
"WHO WILL PAY FOR NEEDED INFRASTRUCTURE"

A. The Non-utility Market Participants

- Will marketers renew their expiring contracts on interstate pipelines at the end of 2005?

It is the decision of marketers whether it is economic to renew expiring contracts or not. Marketers, end-users and LDCs have capacity contracts on different pipelines that have various terms, volumes, and expiration dates. The impact of existing contracts, recent and proposed expansions (e.g. Kern River, LNG, etc), and the individual needs of customers' will impact the economics or the necessity of renewing those pipeline capacity contracts that may expire in 2005 and the extent of any future commitment.

- Will marketers subscribe to new interstate pipelines or pipeline expansions, additional storage facilities, or LNG?

It is a corporate decision that specific companies will make based on a host of variables, including their own requirements and independent assessment of the market.

- How much new interstate pipeline capacity, storage and/or LNG will generators of electricity in California subscribe to?

The generators of electricity should subscribe to capacity requirements, as they independently deem appropriate. The Commission regulates the electric investor-owned utilities (IOU) that are responsible for electric procurement of their (non-Direct Access) customers' requirements. Within the jurisdictional regulation of the electric utilities, the Commission has the ability to oversee and address their appropriate capacity and storage needs.

The terms and conditions within the contractual arrangement between the electric generator and the IOU determine the capacity, price, firmness/level of service and damages for failure to meet terms of contracts. If the electric generator produces electricity using natural gas, then it is that generators responsibility to secure ample gas supply, capacity and storage related arrangements to assure that it abides by the terms and conditions of the contractual arrangement. Likewise, the IOUs may hold contracts with tolling arrangements in which the utility may procure natural gas according to the contract. In this case, the IOU is responsible for securing ample gas supply, capacity and storage related to the tolling agreement and to assure delivery of gas supply under the arrangement.

The regulated IOUs file gas supply plans and the Commission has jurisdictional and regulatory authority over these plans within their review of electric procurement. The planning and policy matters regarding procurement, capacity, storage and financial instruments for electric IOUs should be developed within the appropriate gas supply plans and electric procurement proceedings and not in gas Local Distribution Company (LDC) proceedings.

- Will noncore customers, other than generators of electricity, subscribe to long-term interstate pipeline capacity, storage, or LNG?

The purpose of unbundling is to allow noncore customers to make their own procurement, capacity and storage decisions, and these decisions will be based on the economics of each individual customer. These are typically highly sophisticated customers that are highly capable of forecasting their own natural gas requirements and determining the most optimal manner in which to contract for gas supply, pipeline capacity, storage and financial instruments to meet their individual needs. They are capable of securing commodity, interstate capacity or storage in whatever manner best suits their specific requirements. Some customers may have secured long-term commitments, while long-term commitments may never be suited for some noncore customers' business plan.

Those noncore customers that do not possess the sophistication or market knowledge to make these decisions can become core customers under Commission rules. The Commission rules for noncore to core transfers provide equitable terms and conditions for customers that elect such an option.

While not perfect, the Commission "let the market decide" policy has worked very well. The gas market of 2003 is vastly superior to the market that existed prior to unbundling and the deregulation of natural gas. There have been a number of pipeline expansions that have been mainly market-driven and completed without participation by the regulated LDCs. Most notable were the Pacific Gas Transmission (PGT) expansion (now PG&E GT-Northwest) and the construction of the Kern River Gas Transmission Company pipeline and recent further expansion of that system. These pipeline expansions added significant interstate capacity to the state of California and provide access to new supply basins in the Rocky Mountains, which may otherwise not have occurred under a "command and control" regulatory structure. The Commission should not be concerned with the interstate capacity and LNG supply requirements of the noncore, and not consider reverting back to a policy analogous to a central planning model which endeavors to influence the amount of pipeline capacity that should be constructed or held by LDCs for a baseless public purpose.

- How much of the needed infrastructure will be provided for California's long-term needs excluding the California public utilities' commitments?

The firm infrastructure commitments (excluding those of LDCs for core customers) will be determined by marketers, noncore customers, and interstate pipelines. These are sophisticated customers that can assure that their gas supply and capacity needs are met in the most appropriate manner based on their individual economics and circumstances. As previously stated, new interstate systems have been constructed to serve the California market without the necessity of a regulatory needs test or cost/benefit determination. The uncertainty posed by Commission meddling in the issue of interstate infrastructure for the noncore (such as the recent policy directing LDCs to hold capacity for the noncore) will adversely impact the evaluation process of marketers and noncore customers.

The California Investor Owned Public Utilities

- What should the California public utilities do about their expiring interstate pipeline contracts?

The gas Local Distribution Company's (LDCs) should be provided maximum flexibility to renegotiate under best terms and conditions for its core procurement customers' requirements. The LDCs should be given the opportunity to diversify its firm interstate capacity commitments in order to take advantage of basin-on-basin and pipeline-on-pipeline competition and options available in the market. For SoCalGas, in particular, this is an opportunity for the utility to negotiate aggressively for the most economic and optimal terms and conditions on behalf of its core customers. The Commission should ensure that the LDCs have the opportunity and flexibility to pursue the best capacity commitments for its customers, and not limit or hinder the utilities in any manner. The regulated gas LDCs should not be required to secure interstate capacity on behalf of noncore customers.

- How much of the needed infrastructure should the California public utilities subscribe to?

The California utilities should subscribe to an appropriate level of capacity to meet its utility-specific core requirements within reasonable parameters that provides the flexibility for change as conditions warrant.

- Does there need to be a re-examination of the public service obligations of the California public utilities if there otherwise would not be sufficient infrastructure to meet California's future demand for natural gas?

The Commission adopted a policy to unbundled procurement and interstate capacity from noncore rates so that these customers who possess the capability and sophistication to make decisions regarding their gas requirements can do so independently in the manner which they best meets their own business needs. Noncore customers can make their own independent business decisions concerning gas requirements, infrastructure and procurement without being second-guessed or patronized by regulatory agencies. These customers procure various commodities on a daily basis for their business operations, and energy is but one of those commodities, albeit a very important one. There is no basis for the gas LDCs to undertake any type of public service obligation to assure interstate capacity or supply to meet noncore customers' requirements, especially when in some instances the customers are in fact energy companies. (e.g. electric generators, refineries, etc.) Those customers that do not possess the skills to make these independent decisions can elect to take core procurement service from the LDC.

The Commission adopted a “let the market decide” policy for interstate capacity, which has operated fairly well through the years, and has resulted in significant capacity expansions as previously stated. The Commission has within its purview a significant volume of the infrastructure commitments of its LDCs on behalf of core gas customers and the electric IOU’s to meet their electric procurement load. The Commission should refrain from trying to predict load requirements for noncore customers and picking interstate capacity winners and losers. Furthermore, the Commission should reject any notion that forcing LDCs to secure excess interstate capacity for the market or noncore loads represents a low-cost insurance policy for the market. This type of regulatory thinking and policy will likely have adverse repercussion in the market, primarily in the considerable uncertainty and inconsistent policy it will foster.

ORA has grave reservations concerning any efforts by the Commission to accurately determine the level of interstate capacity that the noncore market needs, whether the proper level of infrastructure exists to meet those needs, and what constitutes the appropriate interstate infrastructure. The requirements of noncore customers can change substantially and the customers themselves are best suited to determine their own supply and capacity needs to assure that their gas demand is served. (A prime example is the recent announced closure of the Shell Bakersfield refinery.) Commission interference in the noncore market will serve to do more harm than any perceived good. The Commission should focus its efforts on an effective protocol for only those interstate commitments necessary to meet core customers’ requirements, and to assure an effective and well functioning intrastate capacity structure for the LDCs.

- What is the ideal mix for the California public utilities in terms of subscription to existing interstate pipelines, proposed interstate pipelines, use of storage facilities and LNG?

The LDCs should focus on securing an optimum level of interstate capacity and storage for its core requirements, which provides some level of diversification among different supply basins with an objective of attaining gas supply at the lowest possible cost. With respect to core procurement requirements, the precise levels of interstate capacity should not be pre-set volumes developed in regulatory proceedings, but determined by the utilities with review/oversight by ORA and Commission. The interstate capacity and supply market will continue to be dynamic and evolve over time, especially given the potential introduction of LNG into the California market in the mid-term future. The Commission would be best served by establishing general and flexible parameters for the LDCs to function within, and not necessarily mandate any pre-established level, formula or structure for interstate capacity. As previously stated, the noncore can make their own decisions regarding interstate capacity and storage.

- Should the California Public Utilities Commission pre-approve the California public utilities' subscription to new contracts with existing interstate pipelines and with new pipelines, storage or LNG facilities?

ORA could support a reasonable pre-approval type process in which it has the capability assure that customers' interests are being properly represented.

- What additional intrastate pipeline expansions might be necessary?

In the mid-term intrastate expansions will likely be associated with potential LNG facilities, and new interstate expansions. Under an unbundled intrastate capacity system, the need to meet increased demand for firm intrastate expansions will be based on the requests and commitments of customers and the associated economics of any expansion compared to existing options. ORA is also receptive to innovative concepts such as third party end-users being able to participate or buy an equity-interest in intrastate expansions, similar to those negotiated by PG&E a few years back.

- How much interstate pipeline and storage capacity should be reserved for core customers?

The interstate capacity and storage reserved for core customers should be based on an economically optimal resource mix in conjunction with some general parameters that assure the utilities will meet the requirements of these customers in a cost effective manner. The LDCs should be able to maintain some flexible parameters associated with their interstate pipeline commitments, such as some seasonal flexibility and reliance on a combination of short-term, mid-term and long-term capacity commitments.

- How should the California public utilities' costs for the entire interstate and intrastate infrastructure be allocated in their intrastate rates?

An appropriate cost recovery method is the unbundled rate structure and method currently adopted for and employed by PG&E. Within this structure, the costs associated with the unbundled rate components of gas supply and procurement, interstate capacity, intrastate capacity and storage (which are reserved) for core customers are included with the core procurement rate, which is adjusted on a monthly basis. The balance of other costs, including distribution and other customer costs are included in PG&E's margin rate component. The core customers are billed on a bundled basis by PG&E, but the most recent unbundled monthly procurement rate component is posted on the customer's bill.

Under the PG&E model, the noncore customers secure gas supply (commodity), interstate capacity, backbone intrastate capacity and storage independently on an unbundled basis. The noncore customers pay for any base margin costs in their distribution rate and customers charges, and also pay a local transmission rate.